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Weekly Report

Weekly FX Market Update

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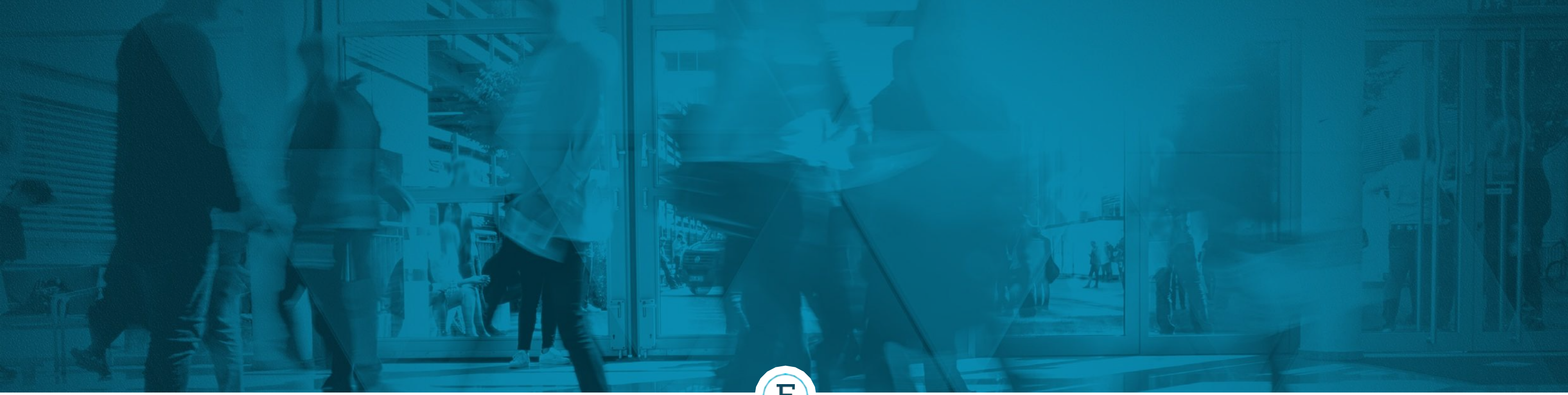


Shrinking GDP, non-committal Fed sink the US dollar

The US economy now meets the barest technical definition of a recession, and Federal Reserve hikes are now fully dependent on inflation and labour data meeting to meeting.

This realisation brought down yields in the US sharply and they in turn knocked down the dollar against nearly every major currency worldwide, save the euro, which continues to suffer from the slow but steady reduction in the flow of Russian gas.

Now that both the Federal Reserve and the ECB have effectively removed forward guidance, central bank hikes are more data dependent than ever. Therefore, focus will be on Friday's labour report out of the US. So far, the jobs market there has remained remarkably resilient to the economic slowdown. The Bank of England meeting on Thursday is expected to deliver a 50 basis point rate increase, and it too is likely to downgrade or remove altogether any explicit forward guidance on rates.

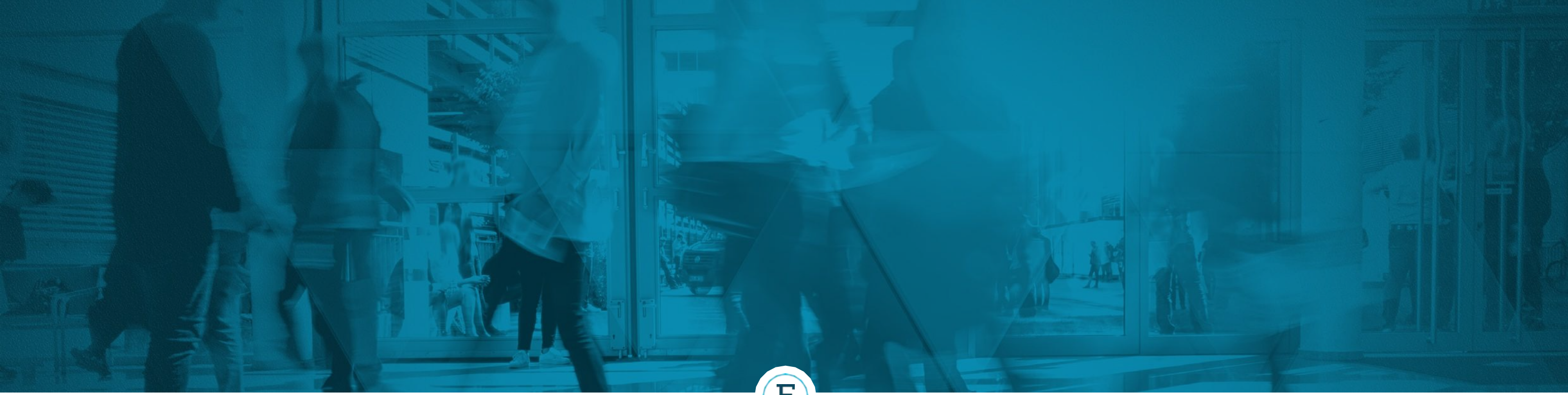
CZK

The Czech koruna ended last week little changed against the euro, with the EUR/CZK pair hovering around the 24.6 level.

Last week's economic data was mixed. Contrary to consensus GDP actually expanded in the second quarter (+0.2% QoQ) meaning the Czech economy almost returned to its pre-pandemic size. More current and forward-looking data was, however, not as positive, with sentiment indicators and manufacturing PMI declining further in July.

This week the attention turns to the Czech National Bank. The first meeting of the new Board will take place on Thursday and markets are split between expecting a small 25-basis point increase or no increase at all. There are good arguments in favour of either, and the decision on rates will likely also depend on the bank's discussion regarding FX interventions, a tool actively used in recent months.

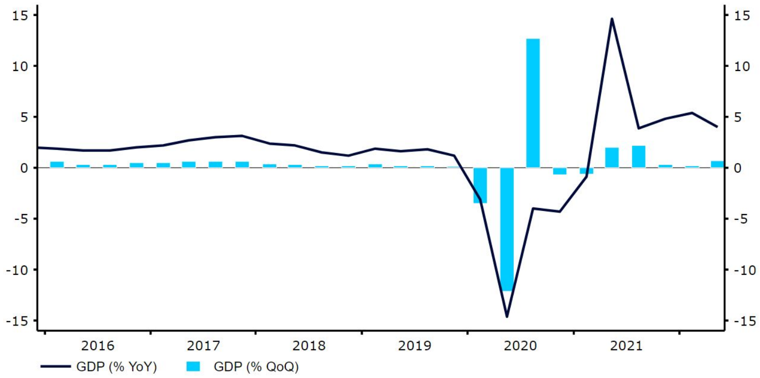
We think this week's interest rate move is a coin toss. A lack of strong market consensus means that assets are likely to react in some capacity to either decision. Aside from the decision itself and the bank's rhetoric on interventions we're awaiting updated economic forecasts. They should give us a better idea of what we could expect from the CNB in coming months, albeit given the uncertain environment, the bank may well suggest a higher degree of data-dependency, in a similar fashion to the ECB or Fed.



EUR

Eurozone inflation once again surprised to the upside, validating our view that ECB interest rate hikes have considerably further to go than interest rate markets seem willing to accept so far. However, the inflation print was overshadowed by the continued reductions in gas flow from Russia, and the announcement of various measures to reduce demand, which understandably are not viewed as euro-positive. Markets mostly overlooked last week's GDP data, which posted larger-than-expected expansion, in favour of the doom and gloom energy headlines.

Figure 2: Euro Area GDP Growth Rate (2016 - 2022)



Source: Refinitiv Datastream Date: 01/08/2022

USD

While it is true that the US economy has printed a slight contraction in two consecutive quarters, we would not call the current economic backdrop recessionary. The unusual combination of stalling growth, full employment and very high inflationary pressures prompted the Fed to de facto withdraw all forward guidance at its meeting on Wednesday, and announce that further moves will be data dependent. Friday wage and inflation data showed no sign that inflation is pulling back to desirable levels, and the high ECI employment cost index data bore increasing hints of a developing wage-price spiral. All in all, we think that market expectations of Fed rates peaking just under 3.25% are too optimistic.

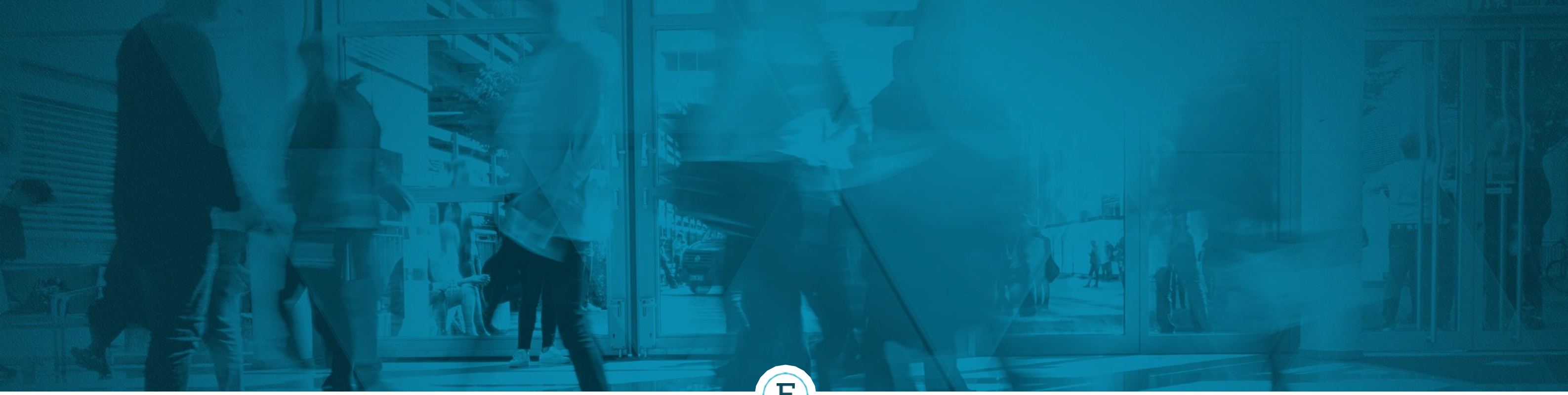
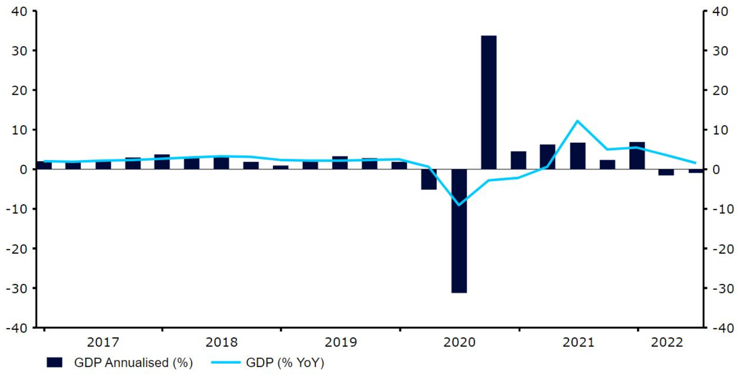


Figure 3: US GDP Growth Rate [annualised] (2017 - 2022)



Source: Refinitiv Datastream Date: 01/08/2022

Markets now turn to Friday's non-farm payrolls report out of the US, expected to show yet another month of healthy job gains in a context of full employment. We will be paying close attention to the wage numbers for confirmation of the above-mentioned feedback between higher prices and higher wages.

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